

General Government Division

B-253611

July 26, 1993

The Honorable Donald W. Riegle, Jr.
Chairman, Committee on Banking,
Housing and Urban Affairs
United States Senate

The Honorable Kent Conrad
United States Senate



This report responds to your request that we provide a status report on the Resolution Trust Corporation's (RTC) administration of its fitness and integrity and conflict-of-interest policies for business contractors and outside legal counsel.¹ RTC's fitness and integrity policies are designed to ensure that RTC generally will not contract with individuals or firms that contributed to the failure of insured depository institutions. As of January 1993, RTC had awarded a total of 105,247 business contracts with estimated fees of \$3 billion and paid another \$818 million for assistance on 78,745 legal matters.

We have identified the thrift cleanup, which is mostly under RTC's control, as one of the 17 federal program areas that is especially vulnerable to fraud, waste, abuse, and mismanagement. In a recent report, we discussed how long-standing weaknesses in contracting and other areas have increased the cost of the thrift cleanup to the taxpayer.² In March 1993, the Chairman of the Thrift Depositor Protection Oversight Board outlined to the Congress some broad initiatives that would be undertaken to improve the management of RTC. One initiative focused on strengthening RTC's contracting system and contractor oversight, and another focused on strengthening internal controls throughout the organization. RTC is developing the specific actions necessary for accomplishing the Chairman's goals. We are reviewing RTC's progress in this area in response to two other congressional requests.

Background

RTC contracts extensively with the private sector to accomplish its mission. In 1992 alone, RTC reported that it awarded approximately 46,000 business contracts with estimated fees of \$1.1 billion. RTC paid \$351 million to legal

¹We previously reported on these issues with respect to business contractors in Resolution Trust Corporation: Monitoring RTC's Fitness and Integrity Policies for Independent Contractors (GAO/GGD-91-134BR, Sept. 25, 1991) and, as part of this request, correspondence on individuals associated with the firm of Financial Management Task Force, Inc., RTC's Fitness and Integrity Review (GAO/GGD 92-31R, Sept. 23, 1992).

²High-Risk Series: Resolution Trust Corporation (GAO/HR-93-4, Dec. 1992).

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July 1993

RESOLUTION TRUST CORPORATION

Better Assurance
Needed That
Contractors Meet
Fitness and Integrity
Standards



93-20795



contractors in 1992, making it one of the largest consumers of legal services in the country.

The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 and RTC's implementing regulations require that businesses or law firms contracting with RTC meet minimum standards of fitness and integrity. RTC is prohibited from contracting with businesses, law firms, or individuals who

- have been convicted of a felony;
- have been removed from or prohibited from participating in the affairs of an insured depository institution pursuant to any final enforcement action by any federal banking agency;
- have demonstrated a pattern or practice of defalcation;
- have caused a substantial loss to the federal deposit insurance funds; or
- are currently in default on one or more obligations to the Federal Deposit Insurance Corporation (FDIC), Federal Savings and Loan Insurance Corporation (FSLIC), or RTC.

In addition to the mandatory requirements indicated, RTC has established discretionary standards that business and legal contractors are required to meet. RTC may determine that a business or legal contractor, not subject to mandatory ineligibility, nevertheless does not meet minimum standards of fitness and integrity to perform work for RTC. For example, a contractor may be found ineligible to contract with RTC because one or more of its employees has interests in an insured depository institution under RTC's control.

Additionally, regarding legal contractors, RTC adopted the American Bar Association (ABA) Model Rules of Professional Responsibility and state bar codes of professional responsibility. These rules provide guidance to attorneys on representational conflicts of interest. According to RTC officials, representational conflicts of interest could affect a private attorney's qualification to work for RTC. For example, a conflict of interest may arise by simultaneous representation of another client either in litigation or a nonlitigated matter. A conflict of interest may also arise if a law firm or a lawyer associated with the firm has a position or interest that places the firm in a posture adverse to RTC.

Business and legal contractors can request a waiver or seek to resolve a conflict of interest to meet RTC's fitness and integrity requirements. RTC can waive its discretionary requirement if it determines that its interest is best

served by engaging a contractor who does not meet the requirement. RTC may place conditions on the contractor before granting a waiver. For example, RTC may require the business or legal contractors to prohibit some employees or parts of the business or law firm from working on or receiving benefits from RTC contracts. This process is called "screening."

Results in Brief

RTC's fitness and integrity process relies primarily on information provided by business or legal contractors or self-disclosure. RTC's policy is to do background checks before awarding certain business contracts—typically those for which the contractor is paid \$50,000 or more annually or that involve handling RTC funds. However, RTC has not established a mechanism to ensure consistent implementation of its policy throughout the organization. For example, RTC does not track or have the internal controls to ensure that the required background checks are done. Our analysis of 30 of RTC's 100 largest business contractors showed that 5 contractors had not received background checks, which RTC officials believed should have been done. Further, during an earlier assignment, we found cases where RTC issued contracts to firms that it later determined did not meet fitness and integrity requirements and would not have received contracts if background checks had been completed.³

In the case of legal contracts, RTC does not require background checks of any of its contractors. According to RTC officials, RTC plans to require background checks of major legal contractors. However, as of April 1993, RTC had not defined the criteria for these background checks or how and when they would be done.

RTC's responsibility to ensure that its business and legal contractors meet fitness and integrity standards does not end when contracts are awarded. Oversight is especially important for contractors who are required to take certain actions—such as screening—to comply with fitness and integrity requirements.

RTC's Ethics Office has overall responsibility for ensuring that business contractors comply with fitness and integrity requirements, including screens. Currently, this process is decentralized, with regional offices overseeing contractors in their regions and the Office of Contract Oversight and Surveillance (ocos) and the Contracts Office providing some input. The Ethics Office is considering some program improvements to enhance these oversight efforts. RTC officials stated that the focus of this

³GAO/GGD-91-134BR, Sept. 25, 1991.

effort is on centralizing the monitoring and oversight of contractors to better ensure that they meet the fitness and integrity requirements.

In the case of legal contracts, RTC has not established policies or procedures for contractor oversight. RTC's Legal Division is responsible for ensuring that contractors comply with fitness and integrity requirements, including screens. The Legal Division plans to identify useful procedures for monitoring and overseeing legal contractors after evaluating the methodology and results of an ongoing RTC Inspector General audit of law firms.

Objective, Scope, and Methodology

Our objective was to determine whether RTC had procedures to ensure that fitness and integrity requirements were being adhered to by its business and legal contractors.

To meet our objective, we reviewed RTC's May 1992 Contract Procedures Manual, RTC's ethics policies, and the Legal Division's policies and procedures for legal contracting. We also interviewed top RTC officials to determine how they implemented these policies and what monitoring mechanism they used to ensure that contractors comply with ethics requirements, including screening.

To identify if cases existed where RTC hired contractors without doing the required background check, we judgmentally selected a sample of 30 contractors from RTC's list of top 100 business contractors with the largest estimated fees. Our sample of 30 included contractors who had 5 or fewer contracts with the highest estimated fees. At our request, RTC examined its records on these 30 contractors to determine if (1) fitness and integrity certification forms were completed and (2) the background check procedure was adhered to in issuing these contracts. Since background investigations are not required for legal contractors, they were not included in this sample.

Additionally, we obtained updated information on RTC's fitness and integrity policies for independent contractors, which we reported on earlier.⁴

We did our work between October 1992 and June 1993 at RTC headquarters in Washington, D.C., in accordance with generally accepted government auditing standards.

⁴GAO/GGD-91-134BR, Sept. 25, 1991.

Fitness and Integrity Process Based on Self-Certification

RTC's fitness and integrity review process relies on information provided by business and legal contractors or self-disclosure. Contractors self-certify that they meet RTC fitness and integrity requirements and that they will bring any changes in their certification to RTC's attention. RTC has established two systems—one for business contractors and the other for legal contractors—for administering its fitness and integrity and conflict-of-interest policies.

Business Contracts

The fitness and integrity process for business contractors typically starts with the contractor submitting fitness and integrity certification forms along with a contract proposal.⁵ In general, the degree and sequence of fitness and integrity review for a specific contract depend on the information the contractor provides on the certification forms or information otherwise available on the contractor.⁶

The review process is composed of a series of steps initiated by the RTC contracting officer and involves

- verifying that the contractor completed the certification forms;
- checking the conflicts database to see if the contractor had previously identified a conflict of interest;
- notifying the Ethics Office if there is a deficiency; and
- requesting a background check if required by the contract type or level of estimated fees; if the contractor is listed on the conflicts database, the certification is forwarded to an RTC ethics officer for a detailed review.

If the answers on the certification forms are satisfactory, conflicts of interest are not identified, and there are no background check requirements, the contract can be awarded after a contracting officer review. According to RTC ethics officials, the majority of contracts awarded by RTC will receive no more than this level of fitness and integrity review. However, RTC will do a more detailed review if the contractor fails to answer a question, fails to provide an acceptable response, provides a qualified response, or a potential ethics issue is identified from the conflicts database. Further, as discussed in this report, RTC's policy is to do background checks on contractors whose fees aggregate to \$50,000, who

⁵RTC established the current procedures, which require that contractors submit certifications along with proposals, in May 1992. Prior to May 1992, firms wishing to contract with RTC were required to provide ethics and conflicts-of-interest certifications to register on RTC's contractor database. Only contractors on this database were solicited for contracts.

⁶RTC's conflicts database contains information provided by contractors who previously sought RTC contracts.

are Standard Asset Management and Disposition Agreement (SAMDA) contractors, or who handle RTC funds or properties.

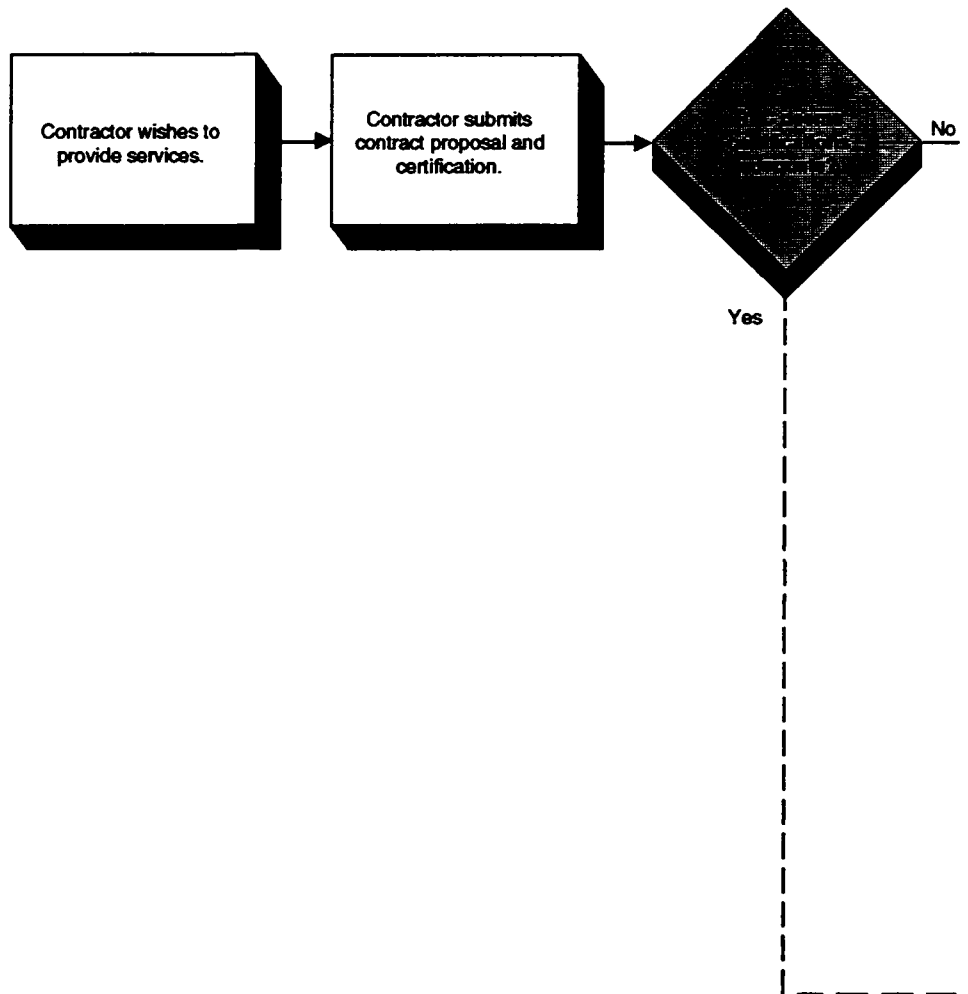
If RTC determines that a contractor does not meet a mandatory requirement, the contractor will not be eligible to contract with RTC. If the contractor fails to meet a discretionary requirement, RTC may grant the contractor a waiver after an analysis of the fitness and integrity issue. This waiver is granted when RTC determines that it is in RTC's best interest to do so or the issue has been resolved to RTC's satisfaction.

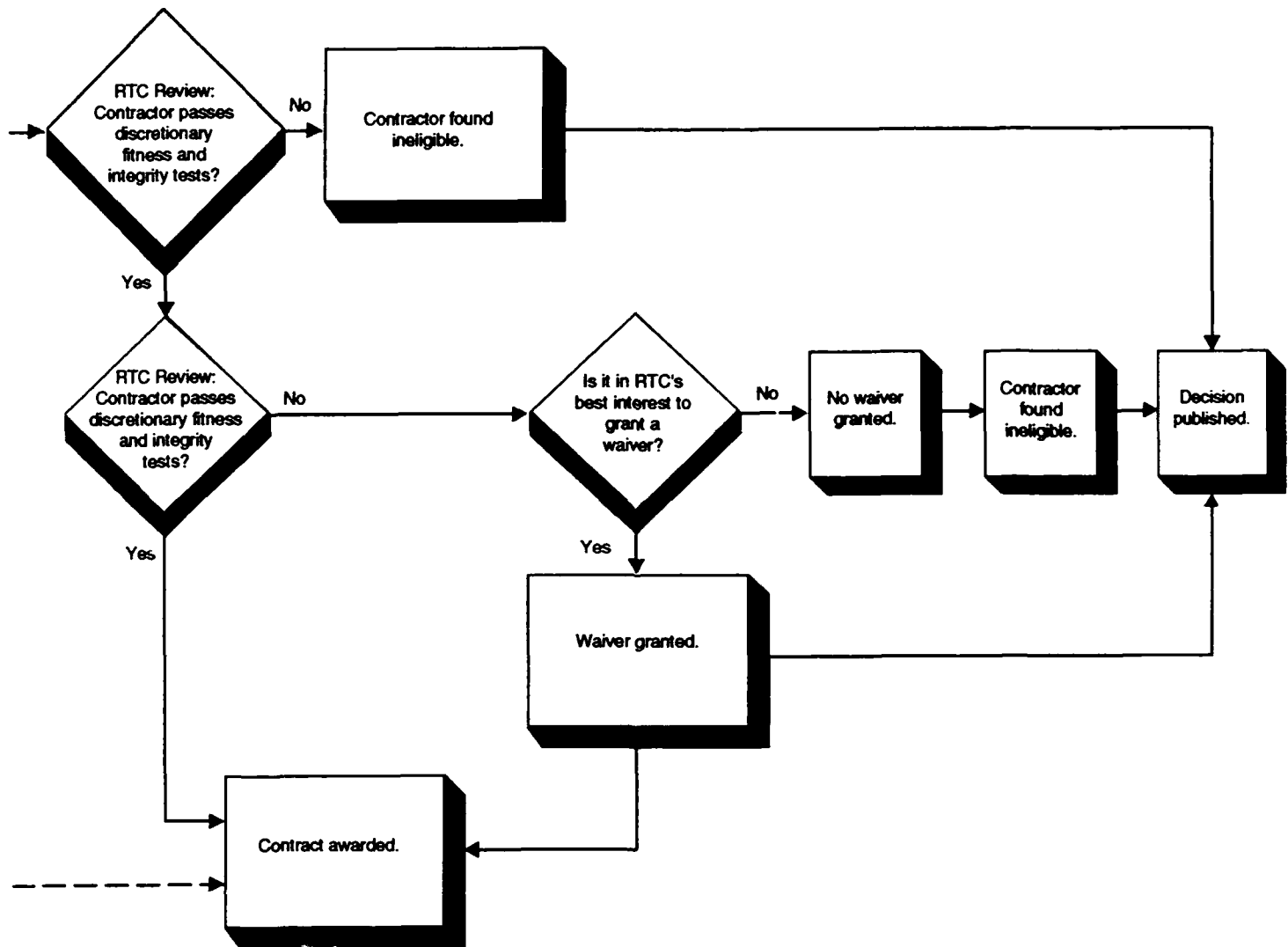
From inception through April 1993, RTC had made 248 decisions regarding waivers for business contractors.⁷ Of the 248 decisions, 7 waiver requests were formally denied, 125 waivers were granted on the condition that the contractor take certain actions, and 116 waivers were granted without conditions. RTC officials noted that the number of waivers denied was low because contractors frequently withdraw their requests when they discover that RTC will be issuing a denial. Figure 1 illustrates RTC's business contractor fitness and integrity review process.

⁷This number includes waivers for personal and organizational conflicts of interest, limitations on contractor activities, and decisions made under RTC's discretionary authority.

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Figure 1: Description of RTC's Fitness and Integrity Process for Business Contractors





--- Business contracts for which additional review is not deemed necessary

 Contracting officers are required to request background checks including verification of contracts with fees over \$50,000, SAMDAs, or other contracts that involve handling RTC funds prior to award.

Source: RTC data.

Legal Contracts

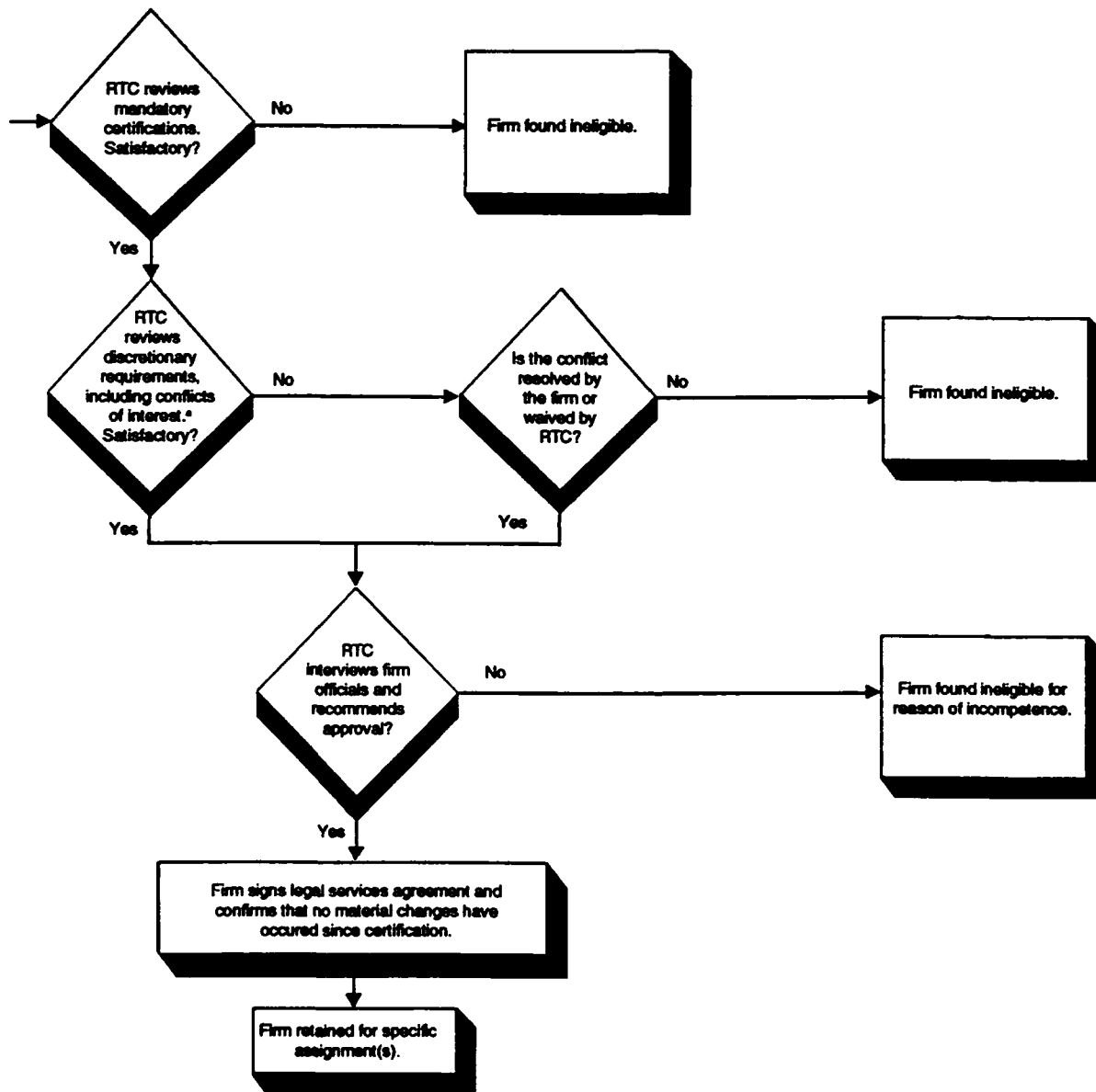
Similar to the procedure with business contracts, law firms wishing to provide legal services to RTC are required to submit fitness and integrity certifications along with their application packages. RTC's Legal Services Division is responsible for reviewing these applications for completeness. However, the Legal Services Division generally does not independently verify the information provided by law firms. As part of the contract award process, RTC interviews eligible law firms to determine if they are competent to provide legal services to RTC. Ethics issues may be raised during this interview.

Law firms that are found competent but fail to meet a discretionary requirement or have a conflict of interest are expected to resolve the conflict or request a waiver. RTC could deny the waiver request, or grant a waiver with or without conditions. A conditional waiver is generally contingent upon a firm taking specific actions to comply or remain in compliance with RTC's fitness and integrity requirements. If the firm is granted a waiver, it becomes eligible to contract with RTC and may then be retained for specific assignments.

From September 1991 to March 1993, RTC's Legal Division took action on 1,034 waiver requests. RTC granted 842 waivers—637 of which contained conditions—and denied 192 waiver requests. Figure 2 illustrates the legal contracting fitness and integrity process.

Figure 2: Description of the Fitness and Integrity Review Process for Legal Contractors





*These reviews are mostly for representational conflicts of interest.

Source: RTC data.

RTC Lacks Assurance That Major Contractors Receive Background Checks

RTC's policy calls for a background check on business contractors whose fees aggregate to more than \$50,000 annually, who are SAMDA contractors, or who handle RTC's funds or property.⁸ On the basis of our review of data from RTC, we determined that about 3,600 (or about 18 percent) of the approximately 20,500 business contractors hired by RTC since its inception had contracts with estimated fees in excess of \$50,000.⁹

The background checks generally entail searching databases for information on firms and their principal employees. Sources include the General Services Administration debarred federal contractor list, a Federal Bureau of Investigation database, Credit Bureau reports, and an FDIC database. These databases contain information on firms and individuals prohibited from contracting with the federal government and data on loan defaults.

Although RTC requires background checks for some business contractors, it lacks systems to ensure that its contracting staff implement this policy. Contract specialists who work on RTC contracts must specifically identify which business contracts require a background check and must initiate action for one to be done. However, RTC does not track these contracts or have internal controls to ensure that the required background checks are done. Evidence from our review of a sample of RTC's top 100 contractors and other monitoring efforts suggested that RTC is not consistently following its procedures.

In reviewing 30 of RTC's 100 largest contractors, we found that 5 contractors with fees ranging from \$6 million to \$34 million had not received background checks. RTC acknowledged that these contractors should have received background checks and that these omissions were oversights on the part of contracting officials. RTC said it is currently resolving these issues.

We previously reported on cases where RTC awarded contracts to contractors who it later determined were ineligible to contract with RTC.¹⁰ For example, RTC awarded 11 contracts valued at over \$21 million to 1 contractor. RTC subsequently determined that a key management official of the contractor had defaulted on loans to insured depository institutions,

⁸As of January 1993, RTC had awarded 236 SAMDA contracts to manage and dispose of \$37.2 billion of real estate and nonperforming loans.

⁹As of March 1993, RTC had awarded approximately 108,000 contracts to 20,500 business contractors; some of them were awarded more than 1 contract.

¹⁰GAO/GGD-91-134BR, Sept. 25, 1991.

thus violating a mandatory bar. RTC's Ethics Office recommended that the contractor be removed from all contracts, and the contracts were rescinded.

In another report, we reviewed a contract in which RTC did not follow its fitness and integrity procedures.¹¹ The official who signed this contract was required to review the contractor's fitness and integrity certification and request a background investigation. Neither was done. The contractor did not submit a certification, a background check was not done, and RTC was not aware of these omissions until we brought them to its attention.

We responded to a citizen's complaint in December 1992 and identified another case where the required background check was not done. RTC officials said that a background check was not done because the responsible contracting officer did not request one. Subsequent allegations that the contractor failed to meet the statutory requirements for fitness and integrity are under investigation by RTC.

As a result of not tracking business contracts that required background checks, RTC lacks certainty that those contractors are consistently receiving background checks.

RTC Does Not Check Backgrounds of Legal Contractors

Contrary to the procedures it established with business contracts, RTC does not require background checks of any of its legal contractors. RTC initially believed that the discretionary standards it adopted, such as the ABA Model Rules and the state bar codes of professional responsibility—and the possibility of disbarment for violating those standards—were sufficient to ensure compliance with fitness and integrity requirements. However, according to RTC contracting officials, RTC now plans to require checks of legal contractors and their principal partners. RTC has not defined the criteria for these background checks or how and when they will begin.

Enhancement to Oversight of Business and Legal Contractors Under Consideration

RTC's responsibility for ensuring that business and legal contractors continue to meet fitness and integrity standards does not end when the contract is awarded. Careful oversight is especially important for contractors who are required to take specific actions—such as implementing screens—to receive the contract.

¹¹Resolution Trust Corporation: Review of Mr. John T. Garrity's Contract (GAO/GGD-93-9R, Dec. 23, 1992).

Business Contractors

The following three RTC organizations are responsible for monitoring and overseeing business contractors to ensure that they comply with contract requirements, including fitness and integrity matters:

The Ethics Office is responsible for the administration, interpretation, implementation, and compliance with RTC's fitness and integrity regulations. In this regard, the headquarters Ethics Office provides policy direction to the regional ethics offices.

The Office of Contracts coordinates the activities of all persons involved in the contracting process. Its primary responsibility is to ensure that adequate competition is used to select winning contractors and to administer contracts once an award is made.

OCOS performs background investigations on the prospective contractors and conducts investigations of fitness and integrity and other contract irregularities. It also reviews contractor performance and compliance with screening requirements where necessary.

RTC's Ethics Office has overall responsibility for ensuring that business contractors comply with fitness and integrity requirements. Currently, the fitness and integrity function is decentralized with regional ethics offices overseeing contractors in their regions. The Contracts Office notifies the Ethics Office of any fitness and integrity matter brought to its attention, and OCOS investigates these issues. Where ethics issues are identified, OCOS also provides the Ethics Office with information developed during performance reviews.

RTC is determining how to better manage its oversight of business contractors' fitness and integrity requirements. For example, the Ethics Office is considering adopting a direct role in managing the regional ethics offices' oversight of RTC contractors. Ethics Office officials said that they will schedule reviews of large contractors, such as SAMDA contractors, securitization contractors, or others who act as a fiduciary for RTC. The Ethics Office is also considering a review of the field offices' oversight of business contractors' fitness and integrity issues. The results of such reviews are expected to provide RTC with information on the extent to which regional offices are implementing fitness and integrity requirements and contractors' compliance with these requirements, including screens.

Legal Contractors

RTC does not require reviews for its legal contractors' compliance with screening requirements. Instead, RTC primarily relies on legal contractors' voluntary compliance with waiver requirements. Accordingly, RTC does not know whether the 637 legal contractors who have been granted conditional waivers have complied with the conditions of their waivers.

The RTC Inspector General's Office is reviewing the billings from 50 of RTC's largest legal contractors. If any of these firms has screens, the Inspector General plans to review compliance with those requirements as part of its work. RTC anticipates that these reviews will help it identify useful procedures for monitoring and overseeing legal contractors on a consistent and routine basis.

Conclusions

RTC relies principally upon independent contractor self-certifications that they meet fitness and integrity requirements. However, without accurate information and a concerted effort to track contracts or contractors that, under RTC policy, should receive background checks, RTC cannot be certain that contractors who do not meet its fitness and integrity standards will be identified.

Moreover, no background checks are required for legal contractors. Although background checks on law firms that contract with RTC would not ensure that all potential ethics or conflict-of-interest issues would be identified, such background checks would help RTC better ensure that its outside counsels meet fitness and integrity requirements.

RTC's responsibility to ensure that business and legal contractors continue to meet fitness and integrity standards does not end when a contract is awarded. RTC plans to improve oversight of its contractors' compliance with fitness and integrity requirements, including compliance with waiver requirements such as screens. The enhancement in contractor oversight that RTC is considering should, if properly implemented, strengthen oversight efforts and provide RTC with better assurance that contractors are complying with the conditions of their contracts.

Recommendations

To better ensure that contractors meet RTC's fitness and integrity requirements, we recommend that RTC's President and Chief Executive Officer

- require background checks for major legal contractors who contract with RTC; this requirement would be consistent with the requirement for major business contractors and
- ensure that checks are being completed as required by developing internal controls to track contractors who should receive background checks.

Agency Comments

We obtained comments from RTC officials responsible for administering fitness and integrity policies for business and legal contractors. The officials concurred with our findings and conclusions and agreed to take steps to implement our recommendations.

We are sending copies of this report to interested congressional committees and Members, the President and Chief Executive Officer of RTC, and the Chairman of the Thrift Depositor Protection Oversight Board. We will provide copies to others upon request.

The major contributors to this report are listed in the appendix. Please contact me on (202) 736-0479 if you have any questions concerning this report.



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